

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF HARDIN)	
COUNTY WATER DISTRICT NO. 1 FOR A)	
DECLARATORY ORDER REGARDING THE)	CASE NO.
APPLICABILITY OF KRS 278.020(1) TO)	2020-00344
PROPOSED IMPROVEMENTS TO)	
MULDRAUGH WATER TREATMENT PLANT)	

ORDER

On November 3, 2020, Hardin County Water District No. 1 (Hardin District No. 1) submitted an application pursuant to KRS 278.020 and 807 KAR 5:001, Sections 15 and 19, for a declaratory order finding that proposed capital improvements to the Muldraugh Water Treatment Plant (Muldraugh WTP) do not require a Certificate of Public Convenience and Necessity (CPCN). No party has requested to intervene in this matter. A representative from the Defense Logistical Agency Energy (DLAE) provided a letter, which Hardin District No. 1 filed in conjunction with its application, indicating that DLAE agrees with the proposed plan for the project at issue and, as proposed, the project will be funded with the proceeds remaining from the Initial System Deficiency Correction Surcharge (ISDC Surcharge) and other funds in the Fort Knox Water Utility Fund.¹ Hardin District No. 1's application for a declaratory order is now before the Commission for a decision.²

¹ Silverstone, Carl, *Letter* (dated Nov. 4, 2020).

² See 807 KAR 5:001, Section 19(7) (indicating that the Commission may dispose of an application for a declaratory order based solely on the basis of the written application and any response thereto); 807 KAR 5:001, Section 19(1) (indicating that the Commission "may" issue a declaratory order upon application).

BACKGROUND

Hardin District No. 1 is a water district organized pursuant to KRS Chapter 74 that owns and operates facilities that produce and distribute water to the public in portions of Breckinridge, Hardin, and Meade counties.³ Hardin District No. 1 provides retail service to over 10,000 customers in Hardin County, Kentucky and provides wholesale water service to Meade County Water District and the cities of Vine Grove, Hardinsburg, and West Point. Hardin District No. 1 provides sanitary sewer service to approximately 8,814 retail customers in Hardin County, Kentucky.⁴ Hardin District No. 1 also provides water service to Fort Knox pursuant to a special contract (Contract) it entered with the DLAE on September 30, 2011, and provides sewer service to Fort Knox pursuant to a separate contract.⁵

Under terms of the September 30, 2011 contract with DLAE, Hardin District No. 1 agreed to provide “potable water utility services” to the Fort Knox Military Installation, and the Government transferred “all rights, title and interest” in its potable water utility system at Fort Knox to Hardin District No. 1 in consideration for the payment of \$8.903 million, payable over ten years at an annual interest rate of 3 percent per annum. In lieu of making monthly payments for the purchase price, the Contract required Hardin District No. 1 to credit the Government’s monthly bill in the amount of \$85,968 for ten years following the purchase. However, the Contract simultaneously created a monthly Purchase Price Recovery Surcharge in the amount of \$85,968 for ten years to compensate Hardin District

³ Application at 2.

⁴ *Id.*

⁵ *Id.* at 3–5.

No. 1 for the purchase cost of the water system, which would be offset by the credit discussed above.

The Contract provides for a monthly utility service charge to cover Hardin District No. 1's operation and maintenance expenses and the cost of renewals and replacements for the water system at Fort Knox.⁶ It requires Hardin District No. 1 to maintain separate accounting for amounts used to provide service to Fort Knox and to routinely compare the accumulation of the "costs invested in owning and operating the Fort Knox potable water utility, plus G&A costs" against revenues received from the Fort Knox monthly utility service charge.⁷ The Contract then provides:

If HCWD1 collects excess funds on its rate charges, the excess funds will remain within the separate account for future use on the Fort Knox potable water utility system only. When total revenue requirements are higher than current rates, HCWD1 will request a rate adjustment.⁸

The Contract indicates that rate adjustments shall be subject to the jurisdiction of the Commission in accordance with FAR 52.241-7: Changes in Rates or Terms and Conditions of Service for Regulated Services.⁹

The Contract identified Initial System Deficiency Corrections (ISDCs), which were defined as projects "necessary to reach the standards typically maintained by the [Hardin District No. 1] on its utility systems so that subsequent renewals and replacements will

⁶ Contract at B.2.2.1.

⁷ Contract at Preamble.

⁸ *Id.*

⁹ Contract at G.4; I.5.3.

permit the longterm safe and reliable operation of the utility system.”¹⁰ The Contract specifically enumerated the ISDCs to be completed and required Hardin District No. 1 to complete them within five years of executing the Contract.¹¹ The Contract provided for an ISDC Surcharge in the amount of \$473,831 to be charged each month for 60 months following the execution of the Contract,¹² although that charge was lowered to \$399,792 after 20 months.¹³ The Contract indicated that the purpose of the ISDC Surcharge was to fund the ISDCs and the amount of the surcharge was based on the estimated costs of the ISDCs.

After Hardin District No. 1 entered into the Contract, Department of Defense (DoD) officials expressed concerns regarding water pressure, water taste, and general water quality.¹⁴ In response to those concerns, Hardin District No. 1 retained Stantec Consulting Services, Inc. (Stantec), to perform hydraulic and water quality modeling and to develop a capital improvements plan designed to address the concerns of the DoD officials.¹⁵ Hardin District No. 1 provided the results of that study and a capital improvements plan to the Government in 2015, and the Government requested that

¹⁰ Contract at C11.2 (defining ISDCs); see also Contract at B.5 (identifying specific ISDCs to be completed and their estimated cost).

¹¹ Contract at B.5 (identifying specific ISDCs to be completed and their estimated cost); Contract at C11.2 (stating that the ISDCs need to be completed with 5 years of the contract start date).

¹² Contract at B.3 (providing the amount, period, and term of the ISDC Surcharge).

¹³ Contract Amendment/Modification No. 00033 (dated Feb. 1, 2017) (produced as part of Hardin District No. 1’s response to Commission Staff’s First Request for Information, Item 1 in Case No. 2019-00067, *Application of Hardin County Water District No. 1 for a Declaratory Order that Proposed Waterworks Improvements to Maintain Adequate and Reliable Water Service to the Fort Knox Military Installation do not Require a Certificate of Public Convenience and Necessity*).

¹⁴ Application at 6.

¹⁵ *Id.*

Hardin District No. 1 submit a proposal for modifications to the initial plan.¹⁶ On September 4, 2015, Hardin District No. 1 submitted a Technical Proposal Submittal, which reported the results of its studies and proposed capital improvement projects to be substituted for ISDCs that had not yet been commenced.¹⁷ Following additional negotiations with the Government, Hardin District No. 1 submitted a final version of the proposal on June 1, 2016, which was accepted by the Government and executed as an amendment to the Contract on August 10, 2016 (2016 Amendment).¹⁸ The 2016 Amendment eliminated a number of ISDC projects as proposed and substituted 17 capital improvement projects.¹⁹

On February 26, 2019, Hardin District No. 1 applied to the Commission for a declaratory order that each of its 17 proposed projects was an extension the ordinary course of business and did not require a Certificate pursuant to 807 KAR 5:001, Section 19.²⁰ Hardin District provided detailed plans and projected costs for 16 of the proposed improvement projects. Those projects were to be paid from the ISDC Surcharge fund and other available funds in Hardin District No. 1's Fort Knox Water Fund Reserve, and the total cost of those projects was well within the proceeds allocated to those funds.²¹ In

¹⁶ *Id.*

¹⁷ Application at 6–7.

¹⁸ Application at 7; see *also* Contract Amendment/Modification No 00029.

¹⁹ Contract Amendment/Modification No. 00029 (dated August 10, 2016).

²⁰ Case No. 2019-00067, *Application of Hardin County Water District No. 1 for a Declaratory Order that Proposed Waterworks Improvements to Maintain Adequate and Reliable Water Service to the Fort Knox Military Installation Do Not Require a Certificate of Public Convenience and Necessity* (filed Feb. 26, 2019), Application.

²¹ Case No. 2019-00067, *Hardin County Water District No. 1* (Ky. PSC May 3, 2019), Order at 6 and 11; see *also* Contract Amendment/Modification No. 00029 (dated Aug. 10, 2016).

Case No. 2019-00067, the Commission found that 16 of the proposed projects qualified for an exception under 807 KAR 5:001, Section 19, as those projects would not materially affect the existing financial condition of Hardin District No. 1 or result in increased charges to its other customers.²² However, the Commission was not able to find that the Muldraugh WTP project qualified for an exception, as the scope and estimate cost of the project was in flux at the time of that application. Hardin District No. 1 acknowledged a significant increase in the estimated cost of the project because additional work was necessary, but could not state the full nature of the necessary work. Likewise, Hardin District No. 1 had estimated the cost of the project would increase from \$4,845,000 to between \$8,000,000 and \$13,000,000.²³ Therefore, the financing for the project was unknown and the Commission was unable to find that the project would not materially affect the existing financial condition of Hardin No. 1 or result in increased charges to other customers.²⁴

Hardin District No. 1 has now filed this application proposing improvements to the Muldraugh WTP to include: (1) replacement of existing high service pumps to ensure compatibility and maximum effectiveness with new water storage tanks and the addition of a fourth high service pump; (2) chemical feed system improvements and redundancy; (3) rehabilitation of filter gallery piping; (4) air scour and surface wash; (5) main treatment plant building rehabilitation and new control room and water quality laboratory; (6) SCADA improvements; (7) installation of grid-based backwash supply; (8) concrete rehabilitation;

²² Case No. 2019-00067, *Hardin County Water District No. 1* (Ky. PSC May 3, 2019), Order at 11– 14.

²³ *Id.* at 7.

²⁴ *Id.* at 11.

(9) perimeter fencing and security enhancements; (10) regrading and paving of parking and delivery areas; (11) conversion of disinfection to chloramines; and (12) influent piping improvements to allow both treatment trains to operate simultaneously, thus increasing treatment plant capacity from 4.5 to 7.0 MGD.²⁵

Hardin District No. 1 opened bids for the Muldraugh WTP project in September of 2020 and initially received two responsive bids which both exceeded Hardin District No. 1's total project funding level of \$16,000,000.²⁶ Hardin District No. 1 negotiated with each bidder and requested reductions for removal of a PAC Slurry Structure from the proposed scope of work.²⁷ The Muldraugh WTP project was then ultimately bid at \$15,273,526 from Dugan & Myers LLC of Louisville, Kentucky.²⁸ Hardin District No. 1 states it will finance the cost of the Muldraugh WTP Improvement Project with funds from the Fort Knox Water Reserve Fund, which has a cash balance of \$17,189,743 and is adequate to cover the proposed construction costs.²⁹

Hardin District No. 1 further states that it is not required to obtain additional DLAE approval of this project's current scope or cost, as DLAE has concurred with the proposed improvements via the prior execution of Contract Modifications (P00029 and P0033).³⁰ However, Hardin District No. 1 has advised DLAE of its current plans and has provided

²⁵ Application at 9–10.

²⁶ Application at 10.

²⁷ *Id.* See also Application, Tabs 6 and 7.

²⁸ Application at 10 and Tab 6.

²⁹ Application at 10.

³⁰ Application, Tab 4 and Tab 5.

two correspondence from DLAE stating there is no objection to the proposed plan of action or funding for the Muldraugh WTP project.³¹

Hardin District No. 1 has requested that the Case No. 2019-00067 be incorporated by reference in this matter. Hardin District No. 1 has also requested an expedited decision by the Commission on this matter, as this project is estimated to take six to nine months to complete, and during that time the Muldraugh WTP will be offline and the Central Water Treatment plant will be relied on to meet Fort Knox's water needs. Should Hardin District No. 1 be unable to complete the project prior to July 1, 2021, summer training scheduled to resume at that time for an additional 20,000 military personnel allegedly will be adversely affected.³²

DISCUSSION

KRS 278.020(1)(a) generally requires a utility to obtain a CPCN before beginning the construction of any plant, equipment, property, or facility. However, a CPCN is not required for "ordinary extensions of existing systems in the usual course of business."³³ An "ordinary extension . . . in the usual course of business" is not defined in KRS 278.020 or elsewhere in KRS Chapter 278. For that reason, the Commission promulgated 807 KAR 5:001, Section 15(3),³⁴ which states:

Extensions in the ordinary course of business. A certificate of public convenience and necessity shall not be required for extensions that do not create wasteful duplication of plant,

³¹ Application, Tab 11. See also Silverstone, Carl, Letter Re: Muldraugh WTP project (dated Nov. 4, 2020).

³² Application at 20.

³³ KRS 278.020(1)(a)1.

³⁴ Case No. 2000-00481, *Application of Northern Kentucky Water District (A) For Authority to Issue Parity Revenue Bonds in the Approximate Amount of \$16,545,000; and (B) A Certificate of Convenience and Necessity for the Construction of Water Main Facilities* (Ky. PSC Aug. 30, 2001), Order at 4.

equipment, property, or facilities, or conflict with the existing certificates or service of other utilities operating in the same area . . . , *and* that do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers.³⁵ (Emphasis added.)

The Commission has interpreted 807 KAR 5:001, Section 15(3), as stating that no CPCN is required for extensions “that do not result in the wasteful duplication of utility plant, do not compete with the facilities of existing public utilities, and do not involve a sufficient capital outlay to materially affect the existing financial condition of the utility involved or to require an increase in utility rates.”³⁶ Applying those criteria, the Commission has previously found that proposed extensions necessary to serve a large, sophisticated customer and wholly funded by that customer pursuant to an agreement with that customer do not require a CPCN, in part, because they will not affect the financial condition of the utility and will not result in an increase in charges to other customers.

In Case No. 2018-00164,³⁷ the Commission held that a CPCN was not required for upgrades proposed by the Natural Energy Utility Corporation (NEUC) to a natural gas pipeline necessary to serve a large industrial customer, stating:

Pursuant to the Agreement, the new industrial customer will pay 100 percent of the proposed construction project costs. The Uniform System of Accounts requires customer contributions to be recorded as a credit to the cost of construction of the gas plant, so the plant construction funded by those contributions will not be recovered from NEUC's other customers. Therefore, the proposed project will not materially affect the utility's existing financial condition and will not require an adjustment of its rates.

³⁵ 807 KAR 5:001, Section 15(3).

³⁶ Case No. 2000-00481, *Northern Kentucky Water District* (Ky. PSC Aug. 30, 2001), Order at 4.

³⁷ Case No. 2018-00164, *The Filing of a Special Contract by Natural Energy Utility Corporation*, (Ky. PSC Sept. 6, 2018) Order at 3.

Similarly, in Case No. 2014-00292, the Commission found that East Kentucky Power Company's (EKPC) construction of a landfill gas to energy facility did not require a CPCN, in part, because it was being constructed pursuant to a special contract in which a wholesale customer agreed to cover all construction and operational costs such that the construction would not materially affect EKPC's financial condition and would not result in an increase in rates to other customers.³⁸

The Commission found in Case No. 2019-00067 that the proposed improvement projects approved therein were similar to those in the NEUC and EKPC matters discussed above.³⁹ Hardin District No.1 has now presented the Commission with the scope and cost of the Muldraugh WTP project, which is to be paid by remaining funds in the Fort Knox Water Reserve Fund. Therefore, the Muldraugh WTP project also adheres to the similarities found in the NEUC and EKPC matters. The proposed project will be used to provide service to the Government pursuant to its special contract with Hardin District No. 1; the Government agreed to fund the construction costs for the project as proposed; the Contract requires Hardin District No. 1 to maintain separate books to separately account for the costs of service to the Government; and the Government agreed to pay all operational expenses necessary to provide service. Thus, as in the cases discussed above, those facts support a finding that the proposed project will not materially affect the existing financial condition of the utility involved or result in increased charges to other customers.

³⁸ Case No. 2014-00292, *Application of East Kentucky Power Cooperative, Inc. for an Order Declaring the Glasgow Landfill Gas to Energy Project to Be an Ordinary Extension of Existing Systems in the Usual Course of Business and a Joint Application of Farmers Rural Electric Cooperative Corporation and East Kentucky Power* (Ky. PSC Apr. 2, 2015).

³⁹ Case No. 2019-00067, *Hardin County Water District No. 1* (Ky. PSC May 3, 2019), Order at 10.

The Commission would again note that there could be a situation where the size of a project in relation to the size of a utility might materially affect the existing financial condition of the utility or potentially result in increased charges to customers, as those terms are used in 807 KAR 5:001, Section 15(3), despite an agreement by a customer to cover all costs. However, there is a limited risk of nonpayment when the counterparty to a contract is the Government. Moreover, this remains a very unique situation because the Government has already paid the funds necessary to complete the project as proposed, and those funds have been specifically allocated to the projects previously completed and the one at issue. The funds will either be spent on the project or will not be spent at all under the current terms of the Contract. Thus, as proposed, the project at issue would not materially affect Hardin District No. 1's existing financial condition of the utility or result in increased charges to its customers as those terms are used in 807 KAR 5:001, Section 15(3).

As previously noted in Case No. 2019-00067, the Commission reached a different conclusion in the case in which it approved the Contract between Hardin District No. 1 and the Government. In that case, the Commission held that certain ISDCs funded through the ISDC Surcharge did require a CPCN, stating, in part:

We do not agree with Hardin District's contention that because the improvements will be funded through the tariffed rate, the cost of the facilities should be considered immaterial.⁴⁰

⁴⁰ Case No. 2011-00416, *Application of Hardin County Water District No. 1 for Approval of a Contract with United States Army to Provide Water Service to the Fort Knox Military Installation* (Ky. PSC Dec. 4, 2012), Order 4, footnote 10.

However, the order in that case provided no further explanation as to why the cost of the projects at issue necessitated a CPCN.⁴¹ Moreover, as stated by the Commission in Case No. 2019-00067,

The Commission continues to agree that the estimated cost of such facilities is not immaterial, estimated costs are only one factor to be considered in determining whether a particular extension will materially affect the existing financial condition of the utility or result in increased charges to its customers. As discussed above, the relevant facts in this matter support the Commission's finding that the proposed projects will not have a material effect on Hardin District No. 1's financial condition or its rates. Thus, following the more recent precedent of the cases cited above, customer funding of facilities is a factor to be considered in determining whether a project is exempt for the requirements of a CPCN, and to the extent that the findings in the December 4, 2011 Order in Case No. 2011-00416 imply otherwise, those findings are modified by this Order.⁴²

The Commission would again note that the proposed Muldraugh WTP project will not qualify for the ordinary course of business exception if it results in wasteful duplication or conflict with the certificate or service of another utility. There remains no real question that the proposed improvements do not conflict with certificate or service of another utility because the improvements to the Muldraugh WTP are for the purpose of providing water service to Fort Knox pursuant to the Contract. Additionally, the evidence indicates that this project will not result in wasteful duplication because the project was initially proposed pursuant to a plan developed by a third-party engineer at the request of the Government to correct water pressure and quality issues; the scope of the project is agreed to by the Government; and Hardin District No. 1 indicated that the project is necessary to correct the service issues raised by the Government, among other

⁴¹ See *Id.* at 3-4.

⁴² Case No. 2019-00067, *Hardin County Water District No. 1* (Ky. PSC May 3, 2019), Order at 12.

things. Thus, the Commission finds that the Muldraugh WTP project as described in this matter will not result in wasteful duplication or conflict with the existing service or certificates of another utility.

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that a CPCN is not required for the proposed improvements to the Muldraugh Water Treatment Plant. The Commission does limit its finding that the proposed project is in the ordinary course of business under 807 KAR 5:001, Section 15(3), and the applicable Commission cases cited herein. The Commission finds that the Muldraugh WTP project does not require a CPCN because it is in the ordinary course of business, will not result in a rate increase, and is pursuant to a contract with the Government. Because the Muldraugh WTP project meets this threshold, the Commission does not need to address the merits of whether the project is exempt from CPCN requirements under KRS 278.020(1)(a)(3).

The Commission's findings are based on the record of this matter, so any material changes to this project or the terms and conditions of the Contract regarding this project not identified herein may affect the Commission's findings that a CPCN is not required for this project.

The Commission does note that KRS 278.160(1) requires, among other things, that "each utility shall file with the commission . . . schedules showing all rates and conditions for service established by it and collected or enforced." Pursuant to 807 KAR 5:011, Section 13, each utility is required to "file a copy of each special contract that establishes rates, charges, or conditions of service not contained in its tariffs."

That regulation applies to contract amendments that establish new rates, charges, or conditions of service not contained in a utility's tariff.

The Contract contains rates and conditions of service subject to the jurisdiction of the Commission. Hardin District No. 1 filed the Contract with the Commission and requested approval for the same, which was previously granted. However, Hardin District No. 1 filed a number of amendments to the Contract in Case No. 2019-00067 and the present matter and the Commission finds that to comply with KRS 278.160 and 807 KAR 5:011, Section 13, Hardin District No. 1 must re-file the Contract with all amendments, as well as any further amendment to the Contract that changes the rate, charges, or conditions of service.

IT IS THEREFORE ORDERED that:

1. Case No. 2019-0067 is hereby incorporated by reference into this matter.
2. Hardin District No. 1's request for a declaratory order is granted.
3. Hardin District No. 1's proposed improvements to the Muldraugh Water Treatment Plant, as described in this matter, are properly classified as ordinary extensions of existing systems in the usual course of business, and a CPCN, pursuant to KRS 278.020(1), is not required for their construction.
4. Within 30 days of the date of this Order, Hardin District No. 1 shall file with the Commission the Contract with all amendments and shall file in the future any further amendment to the Contract that changes any rates, charges, or condition of service.
5. Any documents filed in the future pursuant to ordering paragraph 4 shall reference this case number and shall be retained in the post-case correspondence file.
6. This case is closed and removed from the Commission's docket.

By the Commission



ATTEST:



Deputy Executive Director

Case No. 2020-00344

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